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The Problem of Social Cost

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Description / Abstract

This paper is concerned with those actions of business firms which have harmful effects on others. The standard example is that of a factory the smoke from which has harmful effects on those occupying neighbouring properties. The economic analysis of such a situation has usually proceeded in terms of a divergence between the private and social product of the factory, in which economists have largely followed the treatment of Pigou in The Economics of Welfare. The conclusions to which this kind of analysis seems to have led most economists is that it would be desirable to make the owner of the factory liable for the damage caused to those injured by the smoke, or alternatively, to place a tax on the factory owner varying with the amount of smoke produced and equivalent in money terms to the damage it would cause, or finally, to exclude the factory from residential districts (and presumably from other areas in which the emission of smoke would have harmful effects on others). It is my contention that the suggested courses of action are inappropriate, in that they lead to results which are not necessarily, or even usually, desirable.

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